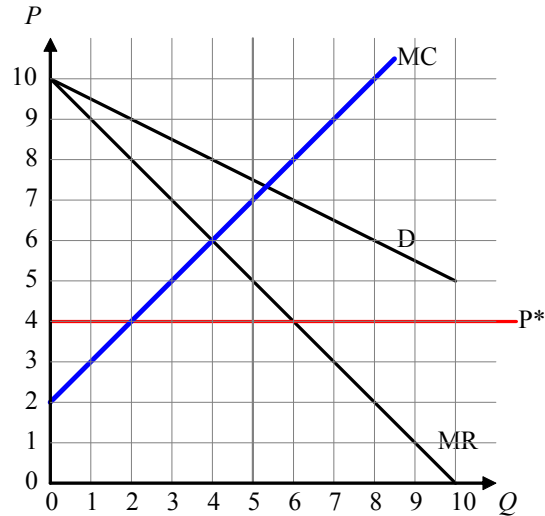
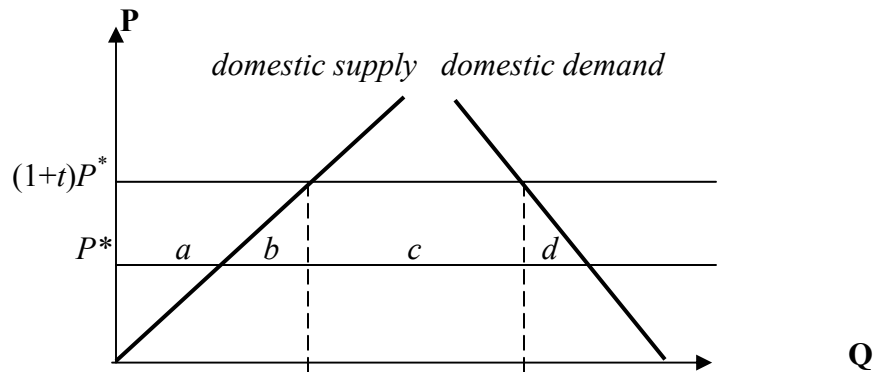


2. The diagram below depicts the market for motorcycles in a developing country. There is only one domestic supplier; its marginal cost schedule is $MC = 2 + Q$ (refer to graph). If there were no trade barriers, imported motorcycles would be available at a price of \$4.



- a) If there is a 100% tariff rate on imports (i.e., $t = 1.0$), what is the domestic price of motorcycles? _____ How many are produced? _____ How much profit (surplus) does the domestic earn? _____ How much surplus do consumers reap? _____
- b) Now assume that the tariff rate has to fallen to 50 percent (i.e., $t = 0.50$) and answer the following questions. What is the domestic price of motorcycles? _____ What quantity is produced domestically? _____ What quantity, if any, is imported? _____ How much profit (surplus) does the domestic earn? _____ How much surplus do consumers reap? _____ Is the economy as whole better off or worse off than when the tariff rate was 100 percent? Explain.
- c) Relative to the initial equilibrium, in which the tariff rate was 100 percent, would an increase in the tariff rate induce more domestic production, less production, or have no effect on domestic production? _____ Would a small decrease in the tariff rate (say, to 75 percent) induce more domestic production, less production, or have no effect on domestic production? _____ Briefly explain the economic forces behind your answers.

- 3) The diagram below depicts the domestic market for bicycles in the presence of a tariff. (Many domestic bicycle manufacturers compete in the domestic market, so monopoly power is totally absent.) The world price of bicycles is identified as P_w , and the tariff rate is t .



Which of the following statements concerning this diagram is correct?

- The tariff generates revenues for the domestic government represented by area c .
- The area $a+b+c+d$ represents the deadweight loss to the economy induced by the tariff.
- The tariff has driven up the world price of bicycles.
- Relative to free trade, this tariff has discouraged some domestic production.